

Spanish Courts, the Court of Justice of the European Union, and Consumer Law

A Theoretical Model of their Interaction

Fernando Gómez Pomar

Facultad de Derecho
Universitat Pompeu Fabra

Karolina Lyczkowska

Centro de Estudios de Consumo, Universidad de Castilla-La Mancha

DLA Piper Spain

*Abstract*¹

Preliminary references to the Court of Justice of the European Union by Spanish courts have experienced a sudden surge in the crisis years, and especially in the past two years. The content of those references is largely linked the protection of consumers facing foreclosures following mortgage loan default. We build a tentative theory of the behavior of Spanish civil and commercial courts based on the observed fact that Spanish courts have been confronted with a pressing social situation affecting large numbers of heavily indebted families, and on our hypothesis that the median court seems to have policy preferences over mortgage debtors protection diverging from that embodied in the Spanish substantive and procedural rules on the matter (both before and after the reforms undertaken post financial crisis). The opportunity to raise preliminary references on the compatibility of Spanish rules with Directive 93/13 changes the strategic interaction between the Spanish Government and the courts, allowing for enhanced opportunities, and reduced costs, for courts to satisfy their preferred policy outcomes as to protection of mortgage debtors. The recent pattern of references seems to fit well with the factors we identify as explaining a larger use of the preliminary reference option by courts.

Las cuestiones prejudiciales planteadas por los tribunales españoles al Tribunal de Justicia de la Unión Europea se han incrementado notablemente en los años de crisis y, especialmente, en los dos últimos años. El contenido de estas cuestiones suele estar vinculado a la protección de los consumidores que se enfrentan a ejecuciones hipotecarias. En este trabajo construimos una teoría sobre el comportamiento de los tribunales civiles y mercantiles que parte, por un lado, de la situación de presión social que afecta a un gran número de familias endeudadas y, por otro lado, de la hipótesis de que el tribunal medio parece preferir políticas de protección de los deudores hipotecarios que difieren de las previstas en las normas sustantivas y procesales españolas sobre la materia (tanto anteriores como posteriores a las reformas llevadas a cabo tras la crisis financiera). La posibilidad de plantear cuestiones prejudiciales sobre la compatibilidad de las normas españolas con la Directiva 93/13 cambia la interacción estratégica entre el Gobierno español y los tribunales, generando mayores opciones, y menores costes, para que los jueces puedan dar satisfacción a sus preferencias sobre las políticas de protección de los deudores hipotecarios. La tendencia de los últimos años a plantear cuestiones prejudiciales parece encajar bien con los factores que, desde nuestro punto de vista, explican un mayor uso de este mecanismo por parte de nuestros tribunales.

Título: Los Tribunales españoles, el Tribunal de Justicia de la Unión Europea y la protección del consumidor: un modelo teórico de su interacción

Keywords: mortgage foreclosures, Consumer Law, preliminary references to the CJEU, game theory

Palabras clave: ejecución hipotecaria, protección del consumidor, cuestión preliminar ante el TJUE, teoría de juegos

¹ Fernando Gómez would like to thank the research funding from ICREA, an agency of the Government of Catalonia.

Summary

1. Introduction
2. Dynamics and rationales of preliminary references
3. The Issues Covered in the Spanish-originated cases
 - 3.1. Courts acting *pro consumatore* on their own motion: the limits of the doctrine
 - 3.2. Financial contracts: unfair terms and mortgage foreclosure
 - 3.3. Still unsolved questions on mortgage enforcement
4. Strategic interpretation of the recent surge in references
5. Conclusions
6. Case-law
7. Bibliographic references

1. Introduction

European Consumer Law has grown and evolved not only by means of harmonization Directives set in motion by the European Commission and supported by Member States, but also, and increasingly so, through judicial lawmaking. The Court of Justice of the European Union (CJEU) has been at the helm of such endeavor of courts' production of consumer law. This prominent role of the CJEU in crafting European Consumer Law has been made possible, to a large extent, by the cooperation and complicity of national courts seeking guidance from the CJEU in the interpretation of EU consumer *acquis* (or, as we hypothesize, perhaps in pursuit of their own policy goals in the field with the instrumental assistance of the CJEU).

To those familiar with European Consumer Law it is not big news to state that some of the landmark consumer decisions of the CJEU have been prompted by preliminary references by Spanish Courts: *Océano*², *Mostaza Claro*³, *El Corte Inglés*⁴, *Banesto*⁵, *Aziz*⁶, just to cite a few. At first blush, thus, it would appear as if Spanish courts should be considered very collaborative and committed participants in the development of European Consumer Law through the expansion and refinement of CJEU case law.

The truth is, however, that the inclination of Spanish courts to ask the CJEU on how to deal with the conformity with EU Law of legal solutions on various issues of consumer contracting, has not followed a uniform or predictable path. Up to a few years back, although not insignificant, Spanish courts had not been particularly prominent or energetic as to their preliminary reference activity in the consumer context or, for that matter, in other areas of the Law.

Recently, the scenario has changed abruptly. Spanish judges, especially those of first instance⁷, have been very active in referring questions for preliminary rulings to the CJEU in connection with the consumer *acquis*, and mostly on the compatibility with European law of different Spanish rules governing mortgage foreclosure. These referrals concern both the mortgage rules pre-existing the financial crisis, and the rules that the successive Spanish Governments and

²Judgment of 27th June 2000, (Cases C-240/98 to C-244/98, *Océano Grupo Editorial*).

³Judgment of 26th October 2006, (Case C-168/05, *Mostaza Claro*).

⁴Judgment of 7th March 1996 (Case C-192-94, *El Corte Inglés*). In this decision, the European ruled that Directive 87/102 on consumer credit could not by itself have direct horizontal effects. Specifically, the provision whose applicability was discussed was the right of action of a consumer against a lender, based on lack of conformity or defects in the supply of goods or services, which was contemplated in the mentioned Directive, but not in the national law, due to delays in transposition. Therefore, without prejudice of the binding nature of Directives as regards Member States, a consumer would not be entitled to a right to claim grounded on a provision in a Directive that has not been yet transposed.

⁵Judgment of 14th June 2012 (Case C-618/10, *Banesto*).

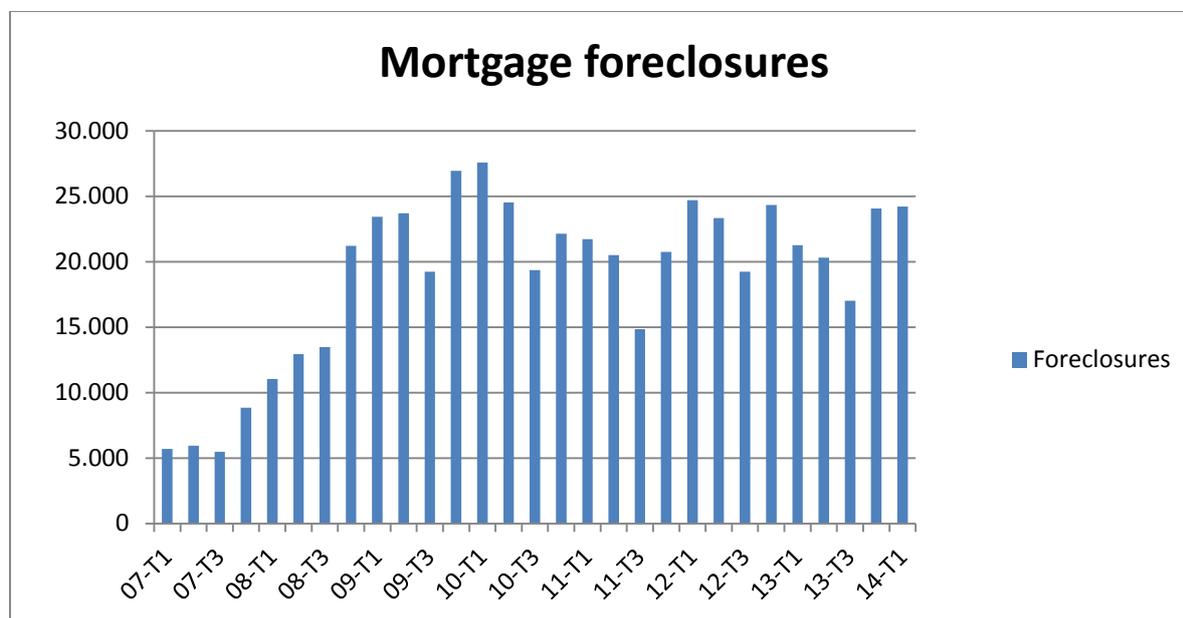
⁶Judgment of 14th March 2013 (Case C-415/11, *Aziz*).

⁷Appeal Courts and the Supreme Court appear to have been more reluctant to raise preliminary references before the CJEU. See, MAYORAL DÍAZ-ASENCIO, BERBEROFF, ORDÓÑEZ SOLÍS (2013, p. 136).

legislatures passed in response to the social unrest raised by the sharp increase in mortgage loan foreclosures, and as a reaction to some decisions by the CJEU dealing precisely with that set of rules.

Social and economic conditions have played a large role in this observable trend in Spanish courts. The severe economic crisis experienced by Spain and other economies after 2008 hit particularly hard in several countries—very prominently, Spain—the housing market. It hit more severely mortgage debtors who, in large numbers, had acquired homes in the years preceding (2002-2007). This period had experienced a housing boom in various places (Ireland, Spain, UK and the US). In the case of Spain, the combination of heavy household indebtedness levels secured by home mortgages⁸, on the one hand, and rising unemployment and decreasing household revenues ensuing from the economic recession on the other, resulted in an explosion of mortgage defaults and foreclosures. This, in turn, negatively affected economic activity in general and aggravated the recession⁹.

The official quarterly data from the Spanish Council on the Judiciary (*Consejo General del Poder Judicial*) on mortgage foreclosure proceedings (addressed against both households and firms: there are no disaggregated data until well into the financial crisis) in Spanish Courts clearly illustrate the phenomenon. The number of proceedings jumps from around 5,500 per quarter in 2007, to over 27,000 per quarter in 2010, an almost fivefold increase in three years. Figure 1 shows this devastating evolution.



⁸ The levels of indebtedness reached peak levels with the housing boom, in large part due to a relaxation in the risk assessment standards observed by Spanish banks (especially savings banks) leading to unjustifiably high loan-to-value transactions, and to interest rate spreads that were too low given the economic conditions of borrowers: See, AKIN, GARCIA MONTALVO, GARCIA VILLAR, PEYDRÓ, and RAYA (2014, pp. 223-243).

⁹ On the role of overindebtedness, and particularly on that of home mortgage debt burdening lower-income families in precipitating and deepening the financial crisis, see, MIAN and SAFIR (2014).

Figure 1

Those households who acquired homes in the peak of the housing boom (2004-2007) were those most hardly hit. According to data on home foreclosures in the second quarter of 2014 just published by the Spanish Statistical Office (*Instituto Nacional de Estadística*), almost 53% of foreclosures affect mortgages agreed just in the span of 3 years, 2005, 2006 and 2007.¹⁰

The scenario we have just sketched has surely led Spanish Courts to —unexpectedly, and we would add, reluctantly— to be confronted with the pressing need of coping on their own with a social emergency affecting large numbers of families. A situation widely publicized by the media, one would add. Why, in the face of this dilemma, they have resorted to the CJEU for assistance in trying to find (some) legal tools to respond to mounting questions about their role in protecting citizens' rights in times of distress is not entirely obvious. It is true that several (though not the majority, by any means) Spanish legal scholars started to criticize the Spanish mortgage system, the foreclosure regime in particular, and denounced the timid mortgage reforms sponsored by the Spanish legislature as chaotic and insufficient for the purpose of protecting mortgage debtors¹¹.

From this perspective, European law (whatever this may exactly mean in the complex scenario of mortgage loan contracts between firms and consumers, where consumer protection rules, procedural autonomy of the Member States, and fundamental rights in the Charter may be intertwined) was perceived by some courts and commentators as a source —perhaps even the only safe one— of legal solutions to a perceived scenario of social urgency, at least in the short term. And mistakenly or not, most courts and observers consider that “time is of the essence” concerning this problem.

Spanish courts, then, turned to the protective rules against unfair contract terms enshrined in European Law, and more particularly, to the CJEU as the authoritative interpreter of their meaning, scope, and application, for a tool to cope with the social pressure to provide legal responses to the unrest caused by the foreclosure crisis in Spain. In this paper we try to offer some (rationality-based) explanations to the phenomenon, and advance a tentative theory of the interaction between Spanish courts, the Spanish Government and the CJEU in times of economic depression.

The article will be organized as follows: In section 2 we will show how preliminary references by Spanish courts have evolved over time, and we refer to the literature that has dealt with the drivers of preliminary reference activity in Spain and elsewhere. Section 3 will summarize the main issues raised by preliminary references from Spanish courts in the consumer context. Section 4 will sketch a stylized game-theoretic explanation for the behavior observed from Spanish courts in this matter as a strategy in their interaction with a Spanish Government with

¹⁰ See INSTITUTO NACIONAL DE ESTADÍSTICA, *Estadística sobre Ejecuciones Hipotecarias (EH)*. Segundo trimestre de 2014. Datos provisionales, available at <http://www.ine.es/daco/daco42/eh/eh0214.pdf>.

¹¹ See, among others, ALCALÁ DÍAZ (2013, p. 238).

divergent policy views on how to deal with mortgage loan defaults. Section 5 briefly concludes.

2. *Dynamics and rationales of preliminary references*

Our first task is to verify whether data support our intuition that Spanish courts have increased preliminary reference filings as a response to the challenges posed by the mortgage foreclosure crisis in Spain and the societal perception of the gravity of the situation. The salience of the issues involved, and our academic proximity to the matter at hand may have biased our estimates of the effects—and their dimension—of the economic recession on the willingness of Spanish courts to resort to the CJEU for solutions in the consumer context.

Data on preliminary references filed by Spanish Courts as contained in Table 1 seem to broadly confirm our intuitions. Although Consumer Law and consumer protection had figured—albeit non prominently—among the subject matters over which Spanish courts had sought guidance from the CJEU in the past, both in absolute terms, and relative to the total number of references from Spanish courts, the numbers have raised very significantly after the crisis, and especially after the consequences of the crisis started to be felt by large portions of the Spanish population in terms of rising unemployment, salary adjustments, mortgage foreclosures and evictions, among other consequences.

Year	Number of requests regarding consumer protection	Total number of requests
1994	1	13
1995	0	10
1996	0	6
1997	1	9
1998*	1	55
1999	0	4
2000	1	5
2001	0	4
2002	0	3
2003	0	8
2004	1	8
2005	1	10
2006	0	17
2007	0	14
2008	3	17
2009	0	11
2010	2	22
2011	2	27
2012	5	16
2013	9	26
2014	12	28

Table 1

It must be noticed that the peak of total number of requests in 1998 showing 55 referrals in reality correspond to only 16 different matters, since there were joined cases (cases C-240/98 to C-244/98, and C-110/98 to C-147/98) dealing exactly with the same issue and provision.

Simply looking at the raw numbers one gets the impression that the number of preliminary references from Spanish courts dealing with Consumer Law was not at all remarkable prior to the 2008 meltdown of the Spanish economy. An even more pronounced increase is observable in the last three years, and more markedly in the current one, where by mid-year Spanish courts had initiated a surprisingly large —given the prior record— number of 12 preliminary reference proceedings on a consumer-related legal issue. Obviously, this has had a large effect on the total number of referrals originating in Spanish courts.

Graphically, the evolution of the total number of references and those concerning consumer matters shows the new post-crisis scenario.

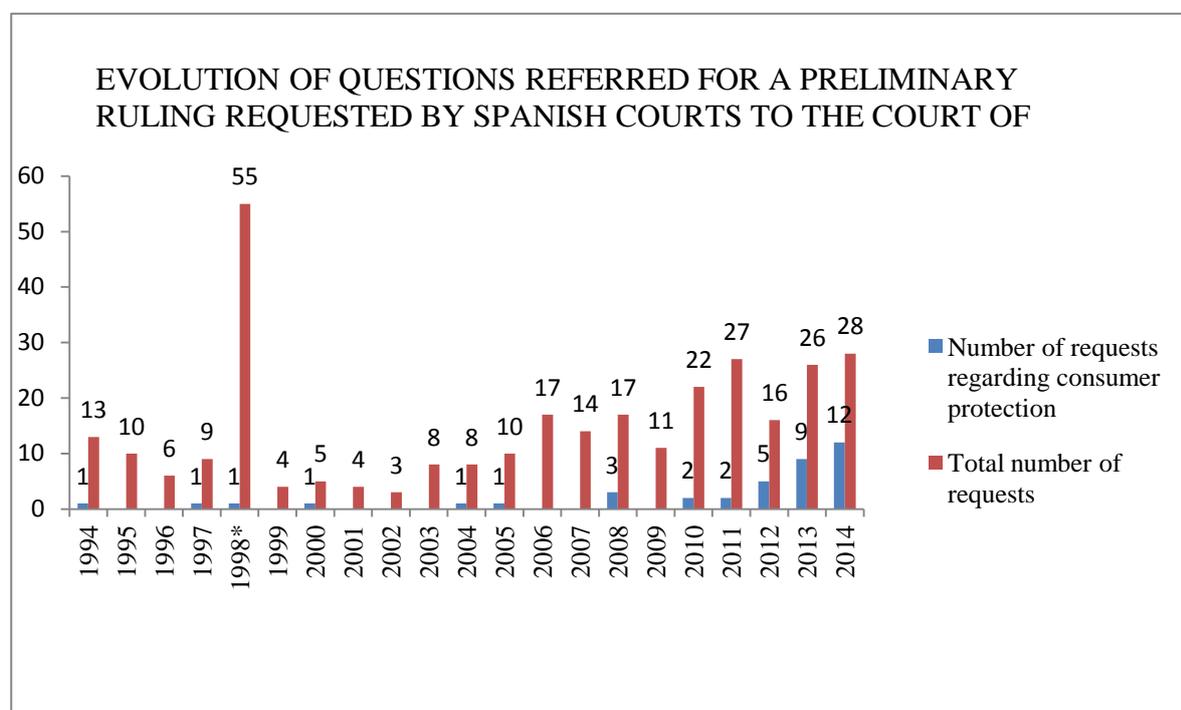


Figure 2

Figure 3 shows the percentage of the total number of Spanish referrals represented by the consumer-related referrals. The pattern after 2008 appears to be distinct from that observable in the second half of the nineties and the first years of the new millennium. The percentages (with the outlier year of 2009) are consistently larger, particularly in 2012-2014. This is an important detail, given the self-reinforcing nature of the strategic incentives to refer matters to the CJEU in order to advance policy preferences divergent from those of the Government and legislature.

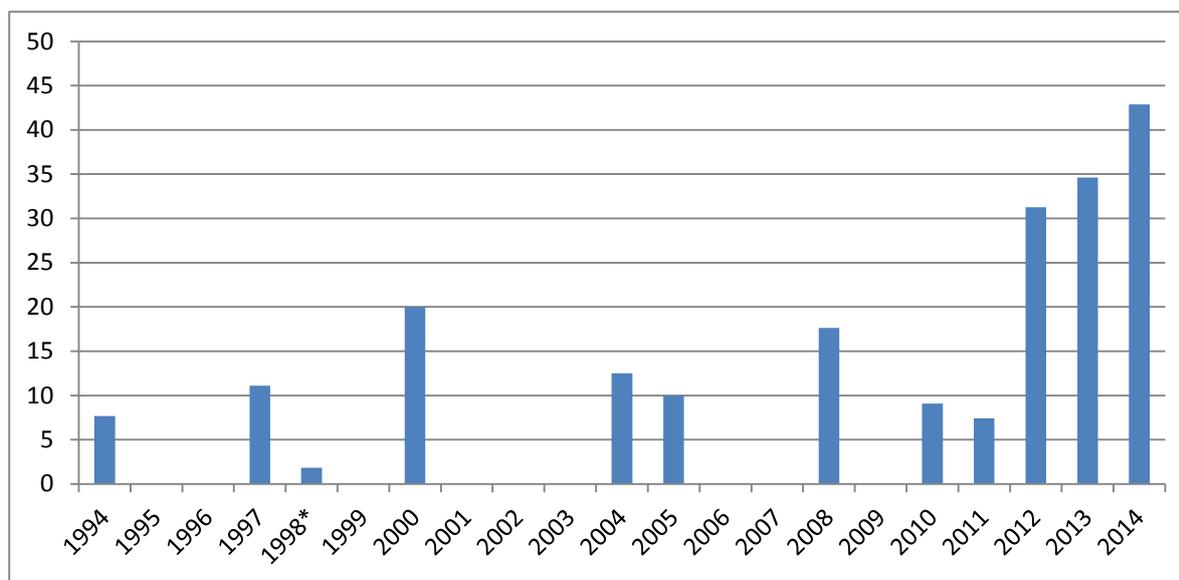


Figure 3

Moreover, the correlation of the number of consumer-oriented preliminary references from Spanish courts to the mortgage foreclosure levels in Spain appears to be present. We do not imply that these figures alone indicate that the economic conditions for large number of families in the aftermath of the financial crisis has “caused” an increase in the number of consumer-related preliminary references.

It seems consistent with the above data, however, particularly if the numbers are complemented with the more detailed analysis of the content of the referrals by Spanish courts in recent years presented in Section 3 below, to argue, as we do, that an important driver of the willingness of Spanish courts (on their own motion, or prompted by the lawyers to the parties facing foreclosure and eviction) to initiate preliminary references on consumer law matters has been the mortgage foreclosure crisis in Spain after 2012. And the foreclosure crisis does not appear to recede (at least for now) even when the Spanish overall economic situation appears to return to positive growth levels (at least at the time of writing this contribution). Recent data from the Spanish statistical office (INE) reveal that the number of home foreclosures in the second quarter of the year 2014, are up by more than 8% over the same quarter of 2013.

Some previous contributions have looked into the behavior of Spanish courts *vis-à-vis* European Law, and more particularly, on the interaction between the courts in Spain and the CJEU, essentially through two channels: a “low-cost” one, represented by citations to CJEU case Law, and a “high-cost” one by means of asking the CJUE for a preliminary ruling. RAMOS ROMEU (2006)¹² has looked empirically at the attitude of Spanish courts towards the precedents set by the CJEU. With a large database of Spanish decisions that either apply or cite European Law, the study finds that Spanish courts tend to “shield” themselves more often behind citations from the CJEU case law when enforcing the supremacy of European Law over domestic Spanish Law, and

¹² RAMOS ROMEU (2006, pp. 395-421).

also when they are ruling against the Spanish Government. Despite this, the author claims that Spanish courts do not seem to be very politically strategic, since he finds that the —favorable or unfavorable— position of the Spanish Government in office *vis-à-vis* a given policy enshrined in a piece of European Law, as proxied by the presence of the Government in the underlying litigation, does not seem to have large explanatory power on the behavior of Spanish courts dealing with European Law issues.

MAYORAL (2012)¹³ uses a database of adjudicatory practices of the Spanish Supreme Court concerning European Law (and comprising, *inter alia*, preliminary references and citations to CJEU case law), to conclude that the “threat” of retaliation by political authorities is an important explanatory variable for citing precedents from the CJEU, a “shielding” strategy to protect their own judgments that may run against the preferences of governmental authorities. The study also claims that there is some “substitution” effect between preliminary references and citations to prior case law of the CJEU, and that the Spanish Supreme Court could prefer to select previous CJEU rulings that fit the legal or policy preferences of the Spanish Supreme Court, rather than risking a new ruling from the CJEU that may not correspond to those preferences.

Even if the latter contention is true generally (of which we remain agnostic), the use of citations to older CJEU cases instead of “prompting” a new —and obviously uncertain in its outcome, content and wording— decision by the CJEU, the appeal of the citation route as an alternative to the preliminary reference one would tend to decrease when: (i) the issue is salient in public opinion, and thus the stakes are higher; (ii) available CJEU case Law does not seem specific enough on the point giving rise to public attention; (iii) the national legislation or policy that may be put into question by European Law is recent, and even posterior in time to the available CJEU case law (a factor that, additionally, would show a commitment by the Government to preserve and defend its own policy view as it is passing legislation that does not fully conform with some readings of CJEU precedents). In sum, the “substitution” effect of the “low-cost” alternative may be significantly weaker under certain circumstances. And arguably this might have been the case of the Spanish scenario in the mortgage foreclosure crisis post-2008.

The pattern of preliminary references across countries and over time has been the subject of an important body of literature. STONE SWEET and BRUNELL (1998)¹⁴ try to offer an explanation of the large differences across Member States in preliminary reference activity, essentially based on a demand theory by firms with transnational operations putting pressure on their national courts in order to file preliminary references on points of European Law that could affect their transnational activities. TRIDIMAS (2003)¹⁵ suggests several factors mutually interacting to explain the reluctance of English courts to use the preliminary reference procedure. TRIDIMAS and TRIDIMAS (2004)¹⁶ offer a public choice theory of the use of the preliminary reference system, as

¹³ MAYORAL (2012).

¹⁴ STONE SWEET and BRUNELL (1998, pp. 66-97).

¹⁵ TRIDIMAS (2003, pp. 9-50).

¹⁶ TRIDIMAS and TRIDIMAS (2004, pp. 125-145).

the outcome of optimizing behavior by private litigants, national courts and the CJEU, and where national courts are essentially seeking to expand their opportunities to influence policy by shifting the battleground from the domestic to the European one, where their position is less vulnerable to political bodies. CARRUBBA and MURRAH (2005)¹⁷ empirically examine the determinants of preliminary reference filings and find that public support for European Integration, and political salience and information have a positive influence on the number of procedures initiated. VINK, CLAES and ARNOLD (2009)¹⁸ empirically reject the hypothesis that cross-border trade explains the variation in preliminary reference activity. HORNUF and VOIGT (2014)¹⁹ find several factors —of a multifarious nature— empirically affecting the level of use of preliminary references: the size of the economy, the structure of the national economy —smaller primary sector— the number of Law students at the *College d'Europe*, certain characteristics of constitutional judicial review in the national legal system, Protestantism as a religion in society, being the most significant in this varied group of explanatory factors. MAYORAL (2012)²⁰ explores differences in the use of preliminary references by courts in old Member States and more recent members in Central and Eastern Europe, and finds that the number of supreme courts in a country (some countries just have one, as Spain, others possess a relevant number, such as Germany) and the structure of judicial review powers in a national legal system appear to be relevant explanatory factors.

We do not intend to generalize our theory on the recent trend of references by Spanish courts in the consumer area. It is true that Consumer Law is one of the largest legal field in terms of preliminary references (after taxation)²¹, but there are many other features of our setting that may not be representative enough to make this a basis for a broader theory. However, we think our stylized explanation of the Spanish case in consumer matters sheds some light on the interplay between national lawmakers, national courts and the CJEU.

3. *The Issues Covered in the Spanish-originated cases*

In this section we will summarize what substantive issues have been decided by the CJEU in the consumer context when responding to references raised by Spanish courts. We are going a while back from the perspective of the recent wave of references, since we think it is illustrative to show the similarities —and the differences, which are clear— in the types of cases and issues raised over time by Spanish courts in their preliminary reference activity.

Spanish courts turned to the CJEU for the interpretation of the scope of applicability of Directive

¹⁷ CARRUBBA and MURRAH (2005, pp. 399-418).

¹⁸ VINK, CLAES, and ARNOLD (2009).

¹⁹ HORNUF and VOIGT (2014).

²⁰ MAYORAL (2012a).

²¹ HORNUF and VOIGT (2014).

85/577 in respect of contracts negotiated away from business premises²² and the possibility of the court acting on its own motion for the benefit of the consumer (*Océano* case). Actually, this last motive appears in several requests for preliminary rulings. In some of these cases, the CJEU has provided Spanish courts with judges the tools to strengthen the consumer's position in the referred case, but in others it decided to set the limits of the available protection, like in the *Corte Inglés* case or *Asturcom*²³ cases.

3.1. Courts acting *pro consumatore* on their own motion: the limits of the doctrine

The *Océano* judgment²⁴ is known for opening this discussion on the judge action of its own motion which later has been followed in the CJEU resolutions of Spanish requests for preliminary rulings. In that case, a contract for sale of encyclopedias was signed which included a clause by virtue of which all disputes arising from it were to be discussed on the court of territorial jurisdiction of the seller's seat (Barcelona). When the seller filed a lawsuit claiming that the price for the books had not been paid up, the relevant Spanish Court looked into the contract and considered that the mentioned clause was legally unfair. Therefore, it refrained from granting the firm's claim, referring to the CJEU, for a preliminary ruling, whether it was possible, on its own, to consider it as a motive for not admitting the lawsuit. The CJEU finally stated that there is a great risk that, due to ignorance of the Law, consumers would not challenge unfair contract terms, and therefore ensuring effective protection of consumers' interests requires the possibility for the Court to exercise the power to evaluate this kind of terms of its own motion. However, in the case at hand there was another obstacle to overcome: Directive 93/13 on unfair terms had not been yet transposed into Spanish law, although the facts postdated the expiry of the period allowed for the transposition. The CJEU ruled that taking this into account, national provisions applicable for the reason of time shall be interpreted, to the extent possible, in accordance with the Directive and in such a way that shall allow the court's own motion.

In the *Mostaza Claro* case²⁵, the discussion focused on the validity of the arbitration clause in a contract for mobile telephone services. As the consumer did not comply with the minimum subscription period set out in the agreement, the service provider initiated arbitration proceedings and obtained a favorable arbitration award. During enforcement proceedings (of the arbitration award) before the court, the consumer contested the arbitral decision, raising the issue of the unfair nature of the arbitration clause, after failing to do the same in the course of the prior arbitration proceedings. The Spanish Court referred the case to the CJEU, asking if it was

²² The Directive excludes contracts concerning rights *in rem* over immovable property. However, as other services included in the contract for use of immovable property on a time-share basis which was discussed were of higher value than the right to use a time-share apartment, the mentioned exception shall not apply according to the Judgment of 22nd April 1999, (Case C-423/97). Therefore, the consumer enjoyed a right of renunciation, which is not subject to any form and unconditional, meaning that it cannot imply payment of any kind of damages for the sole reason of having exercised the right of renunciation.

²³ Judgment of 6th October 2009 (Case C-40/08, *Asturcom* case), see below.

²⁴ Judgment of 27th June 2000, (Cases C-240/98 to C-244/98, *Océano Grupo Editorial*).

²⁵ Judgment of 26th October 2006, (Case C-168/05, *Mostaza Claro*).

possible to avoid an arbitration award on the grounds of the arbitration clause being unfair, even though the consumer did not challenge it properly during the arbitration proceedings. The European Court answered in the affirmative, justifying its response on the imbalance of power between the consumer and the professional. In the circumstances of the case, such a power vested upon the court was considered the only feasible way to ensure that the consumer will not be bound by an unfair term. Therefore, the *Océano* case doctrine was extended to include a case of a passive consumer, at least during the arbitration process predating the court proceedings.

However, this doctrine was slightly modified in the Judgment of 6th October 2009 (Case C-40/08, *Asturcom* case), where the existence of an unfair arbitration clause was observed by the Spanish Court as well, after a lawsuit was brought by a telephone service provider in order to enforce an arbitration award. Nevertheless, unlike in *Mostaza Claro*, the consumer neither participated in the arbitration proceedings, nor brought a claim or counter-claim for annulment of the award before the court. The CJEU stated that a two-month period –during which the arbitration award could have been challenged by the consumer– is a reasonable one, and therefore the award had lawfully acquired the force of *res iudicata*. This time limit was declared consistent with the principle of effectiveness. Therefore, *Asturcom* case seems to put a limit on the *Océano* and *Mostaza Claro* doctrine of the powers granted to courts to overcome the passivity of the consumer.

Nonetheless, in the Judgment of 3rd October 2013 (Case C-32/12), the CJEU, somewhat surprisingly, extends its doctrine one more time in a Spanish case, when it decides that the national Judge may grant the reduction of price due to lack of conformity on its own motion, even though the consumer requested only the rescission of the contract. In this case, the car bought by a consumer presented some defects in its sliding roof so that it leaked when there was rain. After several unsuccessful attempts to repair it, the consumer requested the vehicle to be replaced. However, the Court found the lack of conformity to be minor, and therefore the remedy of rescission of the contract claimed by the consumer could not be granted. A reduction in the sale price had not been requested by the consumer in her lawsuit as a remedy to the non-conformity of the good. The ECJ ruled that even though Spanish civil procedure imposes that the judicial decision should be commensurate (cannot go beyond, or grant something different from the plaintiff's request for judicial relief) with the request made by the parties, these rules are not compatible with the European legislation, as they undermine the effectiveness of consumer protection intended by European Consumer Law. Therefore, according to the CJEU, Directive 1999/44, on certain aspects of the sale of consumer goods and associated guarantees, should be interpreted as precluding national legislation on this point, to the effect that a reduction of the price of the consumer good may be decided unilaterally by the court, even though it has not been requested by the consumer and it is not clear –at least explicitly– whether it better satisfies the consumer's interests²⁶.

²⁶ On the analysis of the Directive's solutions on the lack of conformity from an economic perspective, see among others, GÓMEZ POMAR (2001, p. 20 and ff.). For a critical assessment of the Judgment of 3rd October 2013, see CARRASCO PERERA (2013) (available at <http://blog.uclm.es/cesco/files/2013/10/Consumidor-que-reclama-judicialmente-%C3%BAnicamente-la-resoluci%C3%B3n-del-contrato-de-compraventa-de-un-bien.pdf>); CORDÓN MORENO (2013) (available at <http://blog.uclm.es/cesco/files/2013/11/La-posibilidad-de-que-el-juez-otorgue-de-oficio-una-tutela-jurisdiccional-no-pedida-por-el-consumidor.pdf>).

In the Judgment of 17th December 2009 (Case C-227/08), the CJEU confirms the possibility of the national judge to act *ex officio*. In the case brought before the European Court, a consumer had bought some books and CDs at home, signing a contract with the publisher's representative. When she failed to pay some installments, the professional resorted to the court to initiate an order for payment. However, the court noticed that the contract did not include a right to withdraw consumer's consent within a period of seven days, which should form part of it according to the national legislation transposing the Directive 85/577 in respect of contracts negotiated away from business premises. Once again, the consumer did not claim it and the court was in doubt whether it could raise this infringement *ex officio*. According to the Judgment of the CJEU, the public interest underlying protecting consumer's rights justifies that national courts may act of its own motion.

3.2. Financial contracts: unfair terms and mortgage foreclosure

The second main area of questions referred to the ECJ for preliminary ruling in matters of Consumer Law are those related to financial contracts, especially linked to mortgage loan foreclosure and the unfair terms which the loan contracts may contain. The problem of courts acting on their own motion appears here repeatedly as well.

The *Banesto* case²⁷ is an example of a question regarding the unfair interest rate for late payments in a loan contract with a consumer. In the case, the default interest was set at a rate of 29% (not terribly unusual at the time in a non-secured personal loan to a consumer, it must be said). The bank filed before the court a suit for payment of the seven monthly payments which the consumer had missed, including the applicable default interest. Nevertheless, the court found the default interest excessive and, therefore, unfair. However, given the failure of the consumer to raise an objection on this matter, the Spanish court decided to refer the question to the CJEU in order to clarify whether it could declare the clause void *ex officio*, even though national legislation did not allow it. The CJEU stated that the principle of effectiveness implies that national rules must be interpreted in a way that do not make impossible or excessively difficult to exercise consumers' rights. Therefore, national courts must be able to raise this infringement on their own initiative. However, Directive 93/13 does not provide for a modification of the contract with the unfair clause, permitting only the elimination of the unfair term.

This judgment had an important impact on the prevalent view in the Spanish legal system as to the effects of unfair clauses. Until a recent reform following the CJEU ruling, Spanish legislation on consumers' rights envisaged the possibility of court "moderating" or modifying equitably the rights and obligations of the parties in the case of a finding of an unfair term²⁸. Specially in the case of the interest rate for late payments being found excessive by courts, where a great deal of

²⁷ Judgment of 14th June 2012 (Case C-618/10, *Banesto*).

²⁸ Article 83 of the Royal Legislative Decree 1/2007, of 1st November, on consumers and user's rights. Modified by Law 3/2014, of 27th March.

case law decided in favor of the reduction of the interest rate to an “acceptable” amount (normally, 2.5 times legal interest²⁹). However, as the moderation option seemed an alternative to the total elimination, some of the courts preferred the option of an absolute elimination of the clause, therefore factually reducing the interest rate for late payments to 0%, with an eye on giving the right incentives to credit institutions in order to avoid using unfair terms in this area. Nevertheless, there were also decisions that ruled that, after the elimination of the unfair default interest clause, article 1108 of the Spanish Civil Code should be applied, as a default legal rule, which states that in the absence of a contract term indicating the interest rate for late payments, the “legal” interest –set by default by said provision of the Spanish Civil Code- applies³⁰. After the *Banesto* case and, especially, after the reform operated by Law 3/2014, of 27th March, which implemented the doctrine of that Judgement into Spanish Consumer Law, it seems clear that the only possible way to proceed in case of holding a given term (interest rate or otherwise) is to eliminate the unfair clause entirely, and use the default legal regime that is applicable to fill the gap in the contract.

With respect unfair terms, the Judgment of 16th January 2014 (Case C-226/12) addressing the notion of “significant imbalance” for purposes of a finding of unfairness in a contract term, must be taken into account as well. In a contract for the purchase of a dwelling, the duty to pay the local tax on the increase in value of the urban land (approx. 1.000 euros in that case) had been allocated to the purchaser by a given contract clause. After paying the tax, the consumer brought a claim against the construction company requesting reimbursement on the grounds that the clause imposing the payment of the tax on the purchaser was not negotiated, and it caused a significant imbalance in the rights and obligations of the parties to the contract. The company insisted that the whole contract should be taken into consideration and that from this point of view the alleged imbalance was not significant in economic terms. The Spanish court referred for a preliminary ruling to the CJEU on the meaning of this expression, and the latter stated that the existence of significant imbalance does not require the cost charged to the consumer having a significant economic or monetary impact. There is a significant imbalance when there is serious impairment of the legal situation in which the consumer is placed.

Probably the landmark case, and the most notorious tribute to the relevance of the interactions of Spanish courts with the CJEU is the *Aziz* case. It must be noticed, however, that similar questions on compatibility of Spanish enforcement proceedings with EU law had been answered by the CJEU in its decision of 14th November 2013 (Cases C-537/12 and C-116/13), which derive from proceedings previous to *Aziz*.

The Judgment of 14th March 2013 (Case C-415/11, *Aziz*)³¹ was very influential for Spanish Law. It gave rise to various legal reforms in Spain, after the CJEU ruled that the Spanish Civil

²⁹ By analogy with article 20 of the Law 16/2011, of 24th June, on Consumer Credit Contracts which sets this limit for credit overdraft facilities.

³⁰ A summary of the case law and applicable solutions in Spanish law before the *Banesto* case can be found in LYCZKOWSKA (2013) (available in <http://cesco.revista.uclm.es/index.php/cesco/issue/view/52/showToc>).

³¹ With a commentary by GÓMEZ GÁLLIGO (2014, pp. 153-175).

Procedure Code was not compatible with the level of protection European law grants to consumers. In this case, Mr. Aziz concluded a loan contract secured by a mortgage on his family home. One of the contract's clauses stated—in full compliance with Spanish Law at the time—that in the event of default the bank could bring enforcement proceedings and, for this purpose, the bank may immediately quantify the outstanding amount of the debt by submitting an appropriate certificate with the filing of the lawsuit. When Mr. Aziz stopped paying the loan, the bank instituted enforcement proceedings which led to a judicial auction of the mortgaged property. However, shortly before the court declared that the bank could take possession of the mortgaged property. Mr. Aziz applied to the court for a declaration seeking the annulment of the mentioned clause, on the ground that it was unfair, and with the clause, also the entire enforcement proceedings should go away.

According to Spanish law at the time, such a declaratory proceeding (the one to decide whether the clause was unfair and thus, whether the foreclosure based on the enforcement of that clause should be cancelled) lacked the ability to suspend the mortgage enforcement proceedings, so the court decided to refer a question for preliminary ruling to the CJEU. The latter finally decided that the relevant Spanish procedural rules impaired the protection intended by Directive 93/13, as the objection to enforcement proceedings on the grounds of existence of unfair terms in the contract was not accepted, and thus, the declaratory proceedings had no suspending effect, with the consequence that the vesting of mortgaged property on a third party was irreversible (only monetary compensation would have been available to the consumer prevailing in the declaratory proceedings). As a result, several reforms (implemented by virtue of Law 1/2013, of 14th May) had to be rushed by the Spanish Government, affecting both the Spanish Mortgage Act and the Civil Procedure Code, in order to strengthen the consumer's protection in Spanish law in compliance with the requirements set out in the *Aziz* decision.

But even though *Aziz* case resulted in several reforms of the Spanish enforcement procedures, the recent ruling of CJEU in the *Sánchez Morcillo* case³² clearly shows the insufficiency of the efforts by the Spanish Government to update the procedural framework of mortgage enforcement proceedings to the standards of effective consumer protection sought by the CJEU. The ruling provides an answer to the preliminary reference raised by the Provincial Appeals Court of Castellón, regarding the impossibility of challenging the judicial decision which dismisses the debtor's opposition in mortgage enforcement proceedings.

In the aftermath of the *Aziz* case, the Civil Procedure Code was amended to the effect that the unfairness of a contractual clause was added to the list of possible causes that a consumer could allege in order suspend mortgage enforcement proceedings, if the first instance court deciding such proceedings ruled against the consumer and rejected the plea of unfairness, and thus decided to continue with the foreclosure proceedings, its decision could not be appealed by the consumer. However, if the court ruled in favor of the consumer and the foreclosure proceedings were stopped, the enforcing creditor was entitled to challenge the decision by filing a full appeal against it.

³² Judgment of European Court of Justice, of 17th July 2014 (Case C-169/14).

In the *Sanchez Morcillo* case, the CJEU decides that this situation violates the principle of equality of defense resources available to the parties of a case and therefore, it is not in accordance with Directive 93/13 on unfair terms in consumer contracts. The ruling seems not to fully grasp the scope and properly understand the principles of the Spanish Enforcement Proceedings, when it suggests *obiter dicta* that the whole foreclosure system may be non-compliant with the European Union's principles³³. Nevertheless, a swift reform of the Spanish Civil Procedure Code has been carried out in order to comply with the judgment, solely focusing on the availability of an appeal against first instance court's ruling in these circumstances also for decisions against the consumer and upholding the continuation of the foreclosure proceedings³⁴.

3.3. Still unsolved questions on mortgage enforcement

After *Aziz* the wave of referrals did not slow down. On the contrary, it was perceived by courts throughout the country as clear evidence of a clever way to implement relevant changes in the Spanish legal system in the midst of the foreclosure crisis that had initiated some years before, but that did not appear to recede in 2013. Moreover, there were genuine problems with the interpretation of the reformed Spanish rules following the *Aziz* case, and in connection with the implications of the *Banesto* case doctrine concerning unfair interest rates and the effects of a finding of unfairness. Some of the most recent preliminary references raised by Spanish courts are the ones submitted by the Marchena³⁵, Santander³⁶ and Miranda de Ebro³⁷ first instance judges.

The Marchena court asks how should the judge or the notary act after observing an unfair contractual term related to a default payment interest rate. According to the reform operated by Law 1/2013 in the Mortgage Act, the late payment interest rate in a mortgage loan shall never exceed three times the legal interest rate applicable at the moment. However, for mortgages agreed before it entered into force, the Law envisages a possibility for the enforcing party to recalculate the interest rate in order to meet the new legal limit. On the other hand, in the case of especially vulnerable debtors, Royal Decree-Law 6/2012 establishes that the interest for late payments shall never exceed the sum of the ordinary interest rate plus 2 percentage points. Royal Decree-Law 6/2012 does not contain any transition rule, but it is possible that some courts could take it into account at the moment of recalculation, based on analogical reasoning. In the view of the Marchena judge, these possibilities may be inconsistent with the doctrine of the CJEU in the *Banesto* case, which states that the unfair terms in contract with consumers which shall be eliminated, without modifications being allowed, either by the court or by the party having

³³ For more details on the ruling, and a critical commentary, see CARRASCO PERERA and LYCZKOWSKA (2014) (available at <http://www.uclm.es/centro/cesco/pdf/trabajos/33/27.pdf>).

³⁴ See article 695 of Spanish Civil Proceedings Act, as modified by the Royal Decree 11/2014, of September 5th.

³⁵ Order of the First Instance Court of Marchena, 16th August 2013.

³⁶ Order of the First Instance Court of Santander, 19th November 2013.

³⁷ Order of the First Instance Court of Miranda de Ebro, 15th February 2014.

imposed the unfair term. A very similar concern is raised by the Avila judge³⁸.

The Santander court refers the same question and adds its own doubts about the motives that may lead a judge to consider unfair a clause of acceleration of the payment of a mortgage loan. Since the latest reform conducted by the Law 1/2013, at least three consecutive monthly quotas must remain unpaid before the bank being able to use the acceleration clause. However, there are cases where even though the contractual clause stipulates just one monthly quota unpaid as sufficient for giving rise to the option of the bank to accelerate, credit institutions typically prefer to wait until at least three quotas are unpaid before the enforcement. The Santander court asks whether in these cases it should declare void the unfair term, taking into account that *de facto* the mortgage has not been enforced before the legal minimum has been met.

Finally, the Miranda de Ebro court asks whether the number of monthly unpaid quotas shall be the only factor to consider an acceleration clause as being fair or unfair, without taking into account the duration of the loan, or the percentage of the loan amount that is unpaid in relation to the amounts already reimbursed by the consumer. It refers the same doubts in relation to the late payment interest rate —whether a clause that meets the maximum fixed by the Law (three times the legal interest rate) could be considered unfair due to other circumstances of the case—.

4. *Strategic interpretation of the recent surge in references*

As is clear from sections 1 and 2 above, the number of references from Spanish courts on matters of Consumer Law has skyrocketed in recent years. In this section we explore a game-theoretic explanation of why Spanish courts have engaged in this intense exercise in raising preliminary in references in the aftermath of the financial crisis and its ensuing mortgage foreclosure surge.

In the following analysis we make several simplifying assumptions in order to sharpen the focus upon the main drivers of the strategic interaction between Spanish courts and the Spanish Government, and how the availability of using a reference for a preliminary ruling by the CJEU alters the payoffs and likely outcome of the interaction.

Let's first consider a setting where there is no effective possibility of preliminary references to the CJEU (for whatever reason: imagine the issues involved do not present a relevant connection with EU Law, or the reputational costs of raising the preliminary reference are too high to worth the filing). We have two players, the Government (representing the political majority in the law-making bodies³⁹ in Spain) and the Courts (that we assume may be characterized by a median judge or a representative judge set of preferences).

³⁸ Reference for a preliminary ruling presented by the First Instance Court of Avila n. 3 on February 11st, 2014 (Case C-75/14).

³⁹ Just as a side note, the political majority changed in the middle of the relevant period (2008-2014) but no significant difference was observable between the two in terms of consumer protection in financial matters.

We assume further that there is a relevant difference in preferences concerning the level of protection for consumers in the area of mortgage loans and mortgage foreclosure, between the Government and the Courts. We believe this is a reasonable assumption on the face of the observable facts in the Spanish recent experience: in the midst of a major outbreak of mortgage defaults, given the surge in unemployment and decreasing household revenues, the extremely high levels of homeowners' indebtedness, and the fall in house prices, the Government did not promote or set in motion, on its own initiative, any important changes in the legal framework of mortgage loans and mortgage enforcement. The measures introduced by Royal Decree-Law 6/2012 for vulnerable debtors, including a Code of Good Practice for financial institutions dealing with the restructuring of mortgage debt affecting the place of residence of the debtor, had very little bite in reality: the analysis of the conditions for benefitting of the most important relief measure offered an estimate of no more than 0,77% of total households, or 7,6% of households with all members unemployed being eligible⁴⁰. The more significant (but reluctant) changes brought about by Law 1/2013 substantially followed the case law of the CJEU and specially the *Aziz* case. And no major improvements towards alleviating mortgage debt in personal bankruptcy have been introduced, despite numerous amendments to the Spanish Bankruptcy Act in recent years, and even despite the clear pressure from international bodies, such as the IMF⁴¹ in order to lighten the debt burden on consumers through some type of bankruptcy debt discharge or fresh start.

We are agnostic as to the reasons for such a Governmental position (intact, as we already noticed, throughout two political cycles) *vis-à-vis* the level of consumer protection in mortgage loans, and towards the overall desirability of that attitude. It may well simply reflect a phenomenon of capture of the lawmakers and regulators by the financial industry, as the public choice literature has been characterizing for a long characterizes. Capture, in itself, is also something that may have very different root causes: higher level of expertise in the industry compared to that of lawmakers and regulators; effectiveness of interest group pressure by the financial sector; revolving-doors between industry and regulators, outright corruption, and so forth.

The reluctance to significantly expand the legal protection of mortgaged households, however, may have much more benign underlying reasons. It may simply correspond to a –fuller and more informed assessment of the ultimate economic and social consequences of enhanced consumer protection in this area: may be increasing the level of consumer protection for mortgage debtors would irreparably endanger the financial standing of the Spanish banking system, and thus, the national and European financial stability overall. Whatever the (more or less laudable) reasons underlying the reluctance of the Spanish Government to alter the *statu quo* in favor of heightened levels of legal relief for mortgage-indebted consumers, the observation about the position of the Government is hardly contestable, and that is what matters for our explanation of the preliminary reference activity of Spanish courts.

⁴⁰ CELENTANI and GÓMEZ POMAR (2012).

⁴¹ IMF, Country Report N° 13/245, and Country Report N° 14/193.

As to the Courts, though it is obviously difficult to advance a general statement about their preferences, there are indications consistent with a perceptible feeling of uneasiness about the adequacy of the legal framework in the Spanish legal system towards mortgage debt and mortgage enforcement. Spanish courts have taken over (probably unwillingly) the largest portion of the burdensome task of dealing with unfair terms (in financial contracts but also in other areas of consumer contracting) and with other potential infringements of consumer protection legislation. Public authorities and agencies, both those in charge of consumer protection generally, at the National and Regional levels, and the sectorial regulators and supervisors (Bank of Spain for the financial sector, *Comisión Nacional del Mercado de Valores* for capital markets) have been mostly passive or at least timid in addressing potential violations of consumer protection Law.

Perhaps this has been particularly visible in the financial contracting context. Thus, Courts, willingly or unwillingly, had to step in and assume a major role in this regard. The phenomenon has led to a very significant amount of litigation and increase in the case load of Spanish civil courts⁴².

Moreover, it is also safe to assume that, due to a combination of factors, Spanish Law was not in fact very protective or supportive (compared to other major European legal systems) of overindebted consumers in mortgage-secured loan contracts. There are manifold reasons for this characterization. Some are factual or economic: the levels of home ownership in Spain have been in recent decades—and still are—extraordinarily high for European standards (mostly due to the historic unattractiveness of being a residential landlord in Spain⁴³), and the level of mortgage debt taken by households has been very high, especially in the housing boom years, where the risk assessment standards of Spanish banks and, particularly savings banks, relaxed to the effect that extremely high loan-to-value ratios were financed, also to low-income consumers⁴⁴.

Others are of a legal nature: the privileged status of the mortgage as a security⁴⁵ has given rise to a very efficient property registry, and a set of particularly speedy⁴⁶ court—and out of court, though these have not been widely used in practice—proceedings have been deployed by the

⁴² DELLA NEGRA (2014). Even ADR has not been widely used in Spain with the exception of the scheme introduced to address the case of preferential participations (PPR) that were sold to retail investors by financial institutions, most of them now in public hands following the banking crisis that ensued the economic meltdown in Spain.

⁴³ MORA-SANGUINETTI (2011, pp. 47-75).

⁴⁴ AKIN, GARCIA MONTALVO, GARCIA VILLAR, PEYDRÓ and RAYA (2014, pp. 223-243).

⁴⁵ The legal effects of mortgages, and the favorable comparison between mortgage enforcement outcomes versus bankruptcy outcomes seem to be the most important factors explaining why Spanish firms use mortgage security for their debt much more often and to a larger extent than their counterparts in other European economies: CELENTANI, GARCÍA-POSADA and GÓMEZ POMAR (2010); GARCIA-POSADA and MORA-SANGUINETTI (2012); GARCIA-POSADA and MORA-SANGUINETTI (2014).

⁴⁶ Not just with respect to other types of court proceedings in Spain, but also compared to mortgage enforcement proceedings in other European countries. According to the mortgage industry views, Spain had one of the most (if not “the” most) effective and timely court enforcement mechanism for mortgages.

Spanish legal system at the service of mortgage loans. To this, the absence of almost any—in fact, any at all, before Law 1/2013—avenue or possibility for debt discharge in personal bankruptcy⁴⁷ added to a picture of consumers defaulting on a large scale on their piles of mortgage debt, leading to foreclosures that imply losing the home to the lender and remaining personally liable for the unpaid amount of the loan. The inadequate performance of consumer protection agencies or financial regulators also left ample room for suspicions of unfairness in a number of loan contract clauses (remember, for instance, the high default interest rates in the *Banesto* case).

In Figure 4 we present a very stylized version of the interaction between Government and Courts.

Interaction without CJEU

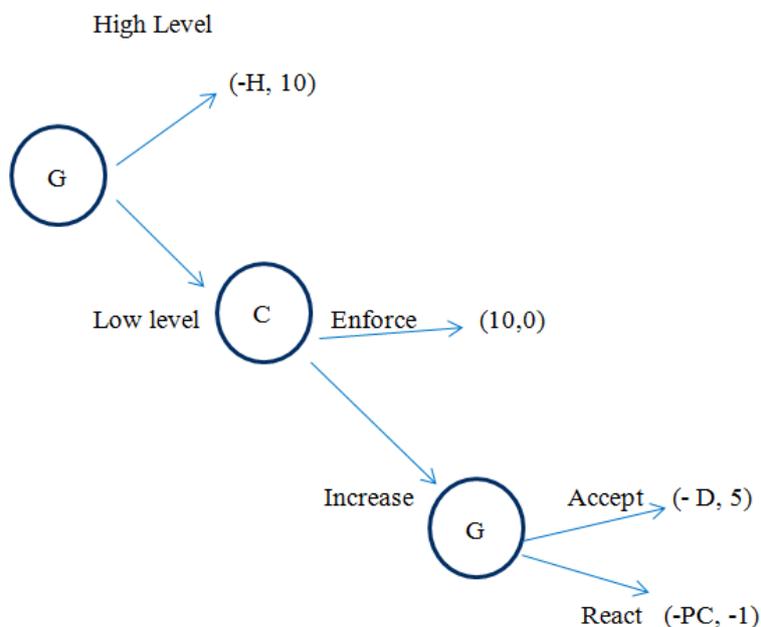


Figure 4

In case the Government opts for changing the legal *statu quo* and for implementing a high level (through rules and/or agency activity on unfair terms, changes in the rules governing mortgage loans, or changes in the procedural rules through which mortgage defaults lead to foreclosure), the Courts are satisfied with the outcome of a high protective level that they find desirable. This

⁴⁷ This leads to extremely low levels of consumer bankruptcy in Spain, since benefits for the debtor of filing for bankruptcy are virtually zero, while transaction costs are not trivial: See, GÓMEZ POMAR and CELENTANI (2012).

results in an attractive payoff for the Courts (10)⁴⁸, who observe their preferred policies actually in place. This is not very attractive for the Government, who incurs a negative payoff of $-H$, which reflects the overall negative effects—or perception of effects—arising from the high level of protection afforded to mortgage debtors: active opposition by banking sector, negative systemic effects on the financial system and the economy, for instance, could add to that negative payoff.

In case the Government decides to keep the existing “low” (at least relatively) level of mortgage debtor protection, Courts face two potential courses of action in this situation: (i) they may choose to abide by the low level that does not correspond to their preferences, thus providing satisfaction to the Government, but sacrificing their preferred view (hence the payoffs of 10 for the Government, and 0 for the Courts); (ii) they may opt for finding (existing or created) avenues to increase in reality the level of legal protection afforded to mortgage debtors⁴⁹.

In the latter case, the Government, in turn, may accommodate the substantive increase in the level of protection granted by the Courts, failing to react against it. The Government may also counteract the departure from existing Law brought about by the Courts, for instance by blocking explicitly the legal avenue opened up by the Courts, or clarifying the potential loopholes in the low protection regime so as to make it extremely hard or virtually impossible for Courts—even when willing to do so—to depart from it in the future⁵⁰.

In the first case, the Government will experience a cost ($-D$), and the Courts will obtain a positive payoff, since their preferred policy outcome will prevail, albeit a lower one that if such an outcome would have been reached by simple enforcement of the level of protection awarded by existing written Law (it seems reasonable to assume that Courts, especially those operating within the Civil Law tradition, will incur costs if, in order to obtain their preferred policy end result, they are placed in the position of “bending” or “circumventing” the legal provisions in force).

In the second, the Government, in order to overcome the move by the Courts to increase mortgage debtors’ protections, would need to incur political costs ($-PC$), in the form of criticisms

⁴⁸ Obviously this figure is arbitrary. We provide a numerical value just for simplicity in the most complex interaction with the CJEU.

⁴⁹ For instance, in two notorious decisions by Spanish courts in 2010, despite the clear outcome to the contrary according to the applicable legal rules, mortgage debtors were discharged of the outstanding debt after the bank had taken possession of the mortgaged property: Order of the Appeals Court of Navarra of 17th October 2010 (in mortgage foreclosure proceedings); Order of the Commercial Court No. 3 of Barcelona of 26th October 2010 (in bankruptcy proceedings). In our stylized account, we do not consider individual departures from enforcement by isolated courts, but a response upheld by a reasonably large number of courts so that the prevailing legal outcome in the circumstances is deemed to have changed.

⁵⁰ This is not an unimaginable or remote scenario. In recent years, the Spanish legal regime on financial guarantees (contained in Royal Decree-Law 5/2005, of March 11th) was amended several times in order to enhance the legal status of banks in derivatives contracts, in order to counteract interpretation by courts that shed doubt on the privileged status of creditors in derivatives contracts, especially in interest rate swaps. See on this interplay between lawmaker and courts, SAEZ LACAPE (2013).

by public opinion, media, courts, legal commentators, and so on, concerning the new piece of legislation opposing the Courts' interpretation and policy option. How large these costs are, or are likely to be, is hard to predict in the abstract, of course. Courts, in turn, following the reaction by the Government, would not only see their preferred policy outcome—high level of protection—discarded, but would have fruitlessly incurred the costs of circumventing the Law in the first place, and perhaps also “confronting” to some extent the legal change ensuing their previous increase in the level of protection afforded to mortgage debtors.

The equilibrium strategies for the Government and the Courts will depend on the relative value of the relevant costs involved (H, D, PC) as well as on the information available to the players when deciding their strategies. If we assume that there is perfect information on the level of costs involved, one would characterize the resulting equilibria in the following way⁵¹:

- (i) if $PC < D$ then (Low level) is a subgame perfect Nash equilibrium. The reason is as follows: given the relatively low political cost for the Government of “correcting” the Courts' deviation from the legally imposed low level of protection, the threat of retaliation by the Government in case Courts fail to enforce the Government's preferred policy option is sufficient to guarantee faithful enforcement by Courts. Anticipating this reaction by Courts, the Government prefers to stick to the low level of protection instead of giving up beforehand and shifting to the high level of mortgage debtors' protection.
- (ii) if $PC > D$, the equilibrium strategies depend on the relationship between H and D. There are two cases: If $D > H$, then (High level) is a subgame perfect Nash equilibrium. Here, Government retaliation following Courts' departure is not credible for the Government (political costs of pursuing this action are too high for the Government), and thus, Courts will always impose their preferred view of high protection level. Anticipating this, and knowing that accommodating this attitude by Courts is more costly than giving up its preferred policy in advance, and thus directly moving to adopt an increase in the level of debtors' protection, the Government simply and rationally acts upon this.

If $H > D$, then (Low level, Accept; Increase) is a Nash equilibrium. Again, Government's reaction against the Courts attitude is too costly, but the Government—who enjoys always a first mover advantage since it can change or amend the Law at any moment it wishes—prefers to stick to low protection levels, obviously well aware that Courts will depart from such a level, and that after that the Government is not willing to incur the (high) costs of reacting against the Court-imposed enhanced protection level.

In terms of the resulting legal regime, in (i) the low level of protection would prevail (and Courts would not risk altering it due to their anticipated fear of Governmental retaliation). In (ii), on the contrary, Courts will see that their preferred policy option is achieved, although perhaps at the cost (for them) of “bending” written Law to expand the level of protection of mortgage debtors. As we clarified before, we do not make any claims as to the desirability of one or the other

⁵¹ We only present strategies on the equilibrium path, and do not fully explore all possible equilibria nor formally characterize the ones we present, given the goal of the present contribution.

outcome. We simply try to illustrate how the interaction between Courts and the Government will be shaped by the structure of the costs of different actions for the latter. This interaction will be altered when Courts are able resort, instead of squarely increasing the level of protection for mortgage debtors, to a preliminary reference to the CJEU, who may —but is not certain to— find that the low level of protection kept by the Spanish Government is inconsistent with European Law.

In Table 2 we summarize the equilibrium strategies of the game when Courts cannot effectively refer the matter to the CJEU.

Summary of strategies on the equilibrium path without CJEU

	PC<D	PC>D
H>D	(Low level; Enforce)	(Low level, Accept; Increase)
H<D	(Low level; Enforce)	(High level)

Table 2

In our second interaction we introduce the CJEU. Not as a player with its own payoffs, but as an external instrument that, through the use of preliminary references, Courts may use in their interaction with the Government on consumer protection issues. Figure 5 shows the interaction with the important addition of the preliminary reference option for the Courts. The rest of the interaction remains as in Figure 4.

Essentially what we have now is that if the Government sticks to the low protection level, Courts, before deciding to enforce it, or to depart from it, have the choice of asking the CJEU for a preliminary ruling on whether a certain feature of the low level of protection package is

consistent or not with European Consumer Law. Going the preliminary reference route implies some direct costs for the Spanish referring Court (delay in deciding, effort in drafting the preliminary reference). Additionally, it also implies with some positive probability, given that the CJEU ruling is not under the control of the referring Spanish Court, foregone benefits for the referring Courts: once a preliminary reference has been raised to the CJEU, if the latter upholds the compatibility of the Spanish low level of protection with European Law, it becomes harder (perhaps even virtually impossible, as we have assumed in our stylized description summarized in Figure 5) for the Spanish Courts not to abide by the written Spanish rules and increase on their own the level of protection. Thus, there are both —certain— direct costs and —uncertain— opportunity costs of making preliminary references.

After receiving the request for a preliminary ruling, the CJEU opts (with an exogenous probability, p , that may depend on a number of factors, such as the content of European Law, or the policy views of the CJEU on consumer matters or on procedural autonomy of Member States, among others⁵²) for revising the level of mortgage debtor protection in Spain on the basis of requirements from the consumer *acquis*, or decides with probability $(1-p)$ that no revision is necessary to satisfy the conditions arising from European Law.

In the first case, we assume that it becomes too costly for the Government to react, or even to ignore, the decision of the CJEU (political embarrassment, international obligations, pressure from other Member States, reciprocity-based motivations to comply with the decisions of the CJEU). Obviously, if the CJEU finds against the European compatibility of the low level of protection regime, the Government incurs a cost ($-D_{cj}$, to indicate that the cost is imposed by accommodating an adverse ruling, not by Spanish Courts, but by the CJEU), since the preferred outcome (at least on the dimensions covered by the CJEU ruling) is no longer sustainable. Whether D_{cj} is larger or smaller than D is a matter of debate, as will be expanded below, and probably the comparison is not amenable to a generalizable answer.

The costs for the Government of an adverse CJEU decision on the level of protection may be higher than those of a domestic ruling, for a variety of reasons: salience of the ruling (given the position and resonance of CJEU compared to purely Spanish decisions, especially if not originating in the Spanish Supreme Court or the Spanish Constitutional Court), political embarrassment at the European level, larger impact of the ruling. But they may also be lower: the CJEU tends to be not too precise on the scope of its preliminary rulings, and leaves ample space of implementation freedom to the Member States; also the pressure from interest groups in the financial industry would be lower, since the possibility of reaction against the ruling are virtually non-existent, which is not the case with a domestic decision increasing the level of debtor's protection.

According to the above, we may either have $D_{cj} \leq D$ or $D_{cj} \geq D$, depending on the specificities of the circumstances and the issues involved. In fact, this adds considerable uncertainty to the calculations by Courts considering the convenience of filing a preliminary reference to the CJEU,

⁵² For the purposes of our analysis we do not need to elaborate a theory about why the CJEU may decide one way or the other in cases as the ones we are considering here.

and it would be hard to make general predictions on many of the possible scenarios.

Interaction with CJEU

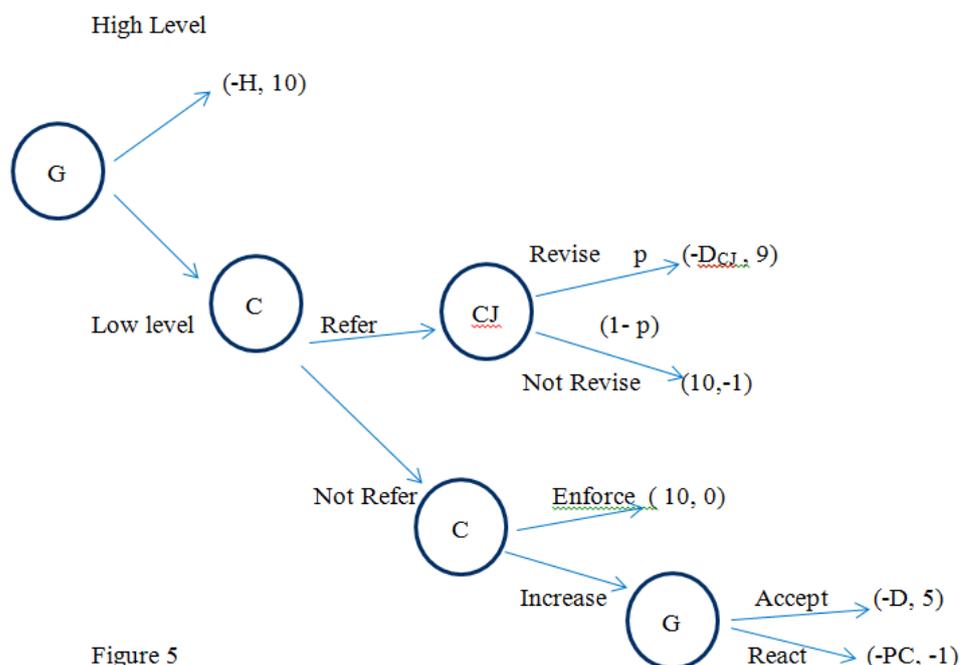


Figure 5

We can, however, draw some useful implications from this stylized representation of the more complex interactions between national Courts and the Government in the presence of preliminary references to the CJEU. In Table 3 we present a summary of the equilibrium strategies in this game of the Government and the Courts in the presence of the CJEU. It is obvious that the latter significantly alters the interplay between Government and Spanish Courts. The effects are complex, as a cursory view to Table 3 will confirm.

Summary of strategies on the equilibrium path with CJEU

p		p<1/10	1/10<p<3/5	p>3/5
D>PC	H<p _{DcJ}	As in Table 2	(High level)	(High level)
	H>p _{DcJ}		(Low level; Refer)	(Low level; Refer)
D<PC	H<D		(High level)	
	H>D		(Low level, Accept; Not Refer, Increase)	
	H<p _{DcJ}			(High level)
	H>p _{DcJ}			(Low level, Refer)

Table 3

First, we know from our discussion of Figure 4 above, that when $PC < D$, Courts correctly anticipate that, in the absence of some other pressure, the Government will stick to low protection levels, and they are aware that the cost structure makes them vulnerable to retaliation by the Government, which will force them into obediently implementing the policy option preferred by the Government (and not by them). In this scenario, the preliminary reference option entails no opportunity costs for Courts, since the probability of prevailing in terms of the preferred policy option is zero without the intervention of the CJEU. Only direct costs of presenting the request for a preliminary ruling matter. If the estimated probability of obtaining a favorable (for their preferences, in this case, against the compatibility of the Spanish low protection level regime with European Consumer Law) is not too low, so as to overcome in terms of expected achievement of desired policy outcomes the direct costs of the preliminary reference filing, Courts will go before the CJEU.

This implies that the use of preliminary references is likely (although not only, as Table 4 clearly shows) to be observed in reality when the Government faces relatively low costs of overcoming a purely domestic “rebellion” by Courts against low levels of mortgage debtors’ protection, and the chances of a revision forced by the CJEU on the Spanish level of protection are deemed by Courts to be not too low. This low level of costs may be inferred from credible signals sent by the Government concerning the level of costs in case of retaliation against local courts departure from written Law.

Additionally, an increase in the *ex ante* estimates by Courts of the chances of a favorable (to their preferred policy option) decision by CJEU, unsurprisingly enhances the incentives of national Courts to call the European Court to intervene. Such an estimate may be raised by the CJEU itself in deciding previous related cases. By showing in a first case its willingness—and the legal basis thereto—to strike down low protection national rules, it encourages more filings in the same area by raising to a larger or smaller extent the assessment made by potentially referring Courts of the likelihood of reaching their preferred policy outcome through the preliminary reference route.

In fact, a larger p (remember, the probability of the CJEU forcing a revision of the level of protection set by the Government) makes the relationship between PC and D (crucial, in the interaction without the CJEU) less important, and raising the relevance of the relationship between H and D_{cj} . Thus, in the interaction that involves the CJEU, preliminary references may also be used as a “threat” by Courts to convince the Government to raise the level of protection in the first place (and at the same time, with the added benefit for the Courts of avoiding the costs for them associated with departing from the written rules in domestic Law). This will be the case when $D < PC$, and $p D_{cj} > H$. In this scenario, the Government will rationally prefer to concede in advance and shift to the high level protection regime

An additional motivation to use the preliminary reference option may be the potential of this procedure to reduce the costs for Courts to achieve their desired policy goals. A direct departure from existing legal rules may be too costly for Courts to undertake, in absolute terms or relative to the costs of abiding with their less preferred policy outcome. If a preliminary reference filing reduces the costs of such departure—for the issue specifically covered by that reference, or for other close enough issues—, this cost-reducing (for Courts to increase the level of protection) property of preliminary references will also help Courts in two scenarios: when $D > H$, and the Courts’ cost of departing from existing Law are high, because the reduction in costs may shift the equilibrium outcome towards (High level); when $D < PC$, because departure from existing Law equilibrium is less costly for Courts.

In sum, there are several avenues through which the availability of preliminary references in the area of mortgage debtors’ protection will be helpful to Courts in order to enhance the likelihood of obtaining their desired policy option, or to reduce the costs necessary for them to achieve that result.

We believe that the strategic advantages that the use (actual or threatened) of the preliminary reference procedure give Spanish courts has been at work in recent years in the consumer context. A few observations of the way events unfolded seem to correspond to at least one of the advantageous effects for Courts. In the area of mortgage debtors’ protection, even in the midst of a very serious foreclosure crisis, the Spanish Government (in the two political cycles affected) had sent various signals showing that it was committed to the low protection regime and that it would use legislation to avoid any deleterious consequences of consumer protection developments on the mortgage loans portion of the banks’ balance sheets.

Among these signals we could mention the very narrow reach of moratoria in foreclosures and similar relief measures, even for severely distressed households; lack of changes in substantive mortgage laws, and merely cosmetic ones in enforcement procedure; refusal to introduce, in the various amendments to the Bankruptcy Act implemented during the crisis years, any form of debt discharge and fresh start for consumers. All these signals could be interpreted as indicating not only unwillingness to alter the existing legal framework, but also to resist, or counteract, case Law developments producing all but minor fractures in that structure.

On the other side, the CJEU also appeared to send signals (in the *Banesto*, and very obviously, in the *Aziz* case) that it was prepared and willing to review the Spanish entire substantive and procedural legal ensemble of rules governing mortgage loans under quite exacting standards of effectiveness of consumer protection against unfair terms (of which perhaps there was no shortage in loan contracts now in default and leading to foreclosures). This led to a window of opportunity for Spanish Courts willing to incur some costs to provide relief to consumers defaulting on mortgage loans. With a closer or looser (sometimes very loose indeed) link to unfair contract terms European provisions, they sought new rulings by the CJEU on different issues affecting mortgage loan contracts and their enforcement. They tried to maximize the chances of “prevailing” on different dimensions of the Spanish legal framework governing mortgage loans. Evidence of this is that the referrals have been closely attached in their formulation to previous rulings of the CJEU concerning Spanish Law on mortgage loans and their enforcement. It seems that the referrals generate (favorable to the Courts’ preferred policy options in general) rulings that, in turn, generate more new referrals.

It does not seem unfair to think that we are currently in the middle of this type of process. Our stylized depiction of the interaction, we believe, sheds light on the forces and the factors bearing on the observed trend in preliminary references in the consumer setting by Spanish Courts, and on the consequences they may entail for Spanish Law on mortgage loans and mortgage foreclosure, and perhaps for Spanish Consumer Law more generally.

A very legitimate issue to raise would be that of timing concerning the discrepancy in policy preferences between Government and Courts. The Spanish regime governing mortgage foreclosures was by no means new. It had been in force for a long time, and apparently Courts had not revealed themselves unhappy with the set of solutions in place, and had routinely enforced them without hesitation. Why has the dramatic change in the macroeconomic situation had such a profound effect in the preferred policy views of Courts compared to those of the Government?

One may conjecture that Courts are aware that mortgage loan foreclosure, with a higher or lower level of protection to consumers, is necessary to alleviate debtor’s moral hazard, otherwise pervasive without legal means to impose negative consequences on loan default. In good economic times, however, defaults on mortgage loans are more likely to be ascribed to undesirable behavior by debtors than in rough economic times for all households. Thus the advantages of a high protection regime would be perceived to be low, or at least lower than in a harsher economic climate. When economic conditions change, Courts may rationally change their perception about the root causes of default, thus making the high protection alternative more appealing to them as preferred policy option. The Government may, despite the new macroeconomic scenario, still prefer the low protection regime for the variety of factors and reasons mentioned above, and ranging from capture to prudent anticipation of systemic consequences.

5. *Conclusions*

The pattern of preliminary references by Spanish courts dealing with consumer matters offers a very interesting setting to explore the reasons and factors behind —uncoordinated and disaggregated, at least on the face of them— decisions by courts to refer issues to the CJEU. Undoubtedly, the fact that Spanish civil and commercial courts have been confronted with the pressing need of coping on their own with a social emergency affecting large numbers of families who face serious risk of eviction and foreclosures on their homes, in situations of severe economic distress, and with very high levels of indebtedness, has played a large part in the recent upward trend of preliminary references.

In the paper we have explored the economic environment that gave rise to a challenge for courts to provide answers through the law to social needs affecting wide portions of the population. We have essentially tried to offer an explanation for the observed pattern of preliminary references. In our explanation we have emphasized the strategic underpinnings of the interactions giving rise to the wave of preliminary references.

Not because we think the purely legal dimensions having to do with the interpretation of different provisions of the Spanish legal regime and the principles of consumer protection underlying European Consumer Law, and particularly Directive 93/13, are not important in explaining how and why Spanish courts and the CJEU acted as they did —and still do—. And the influence of legal factors is not, we conjecture, idiosyncratic to the courts in Spain in their dealings with the CJEU. We think, however, that our stylized explanation of the Spanish case in consumer matters allows us to understand in a somewhat more precise form several relevant features of the interplay between national lawmakers, national courts and the Court of Justice of the European Union. And this not only in the special circumstances of the mortgage loan foreclosure crisis afflicting Spain in recent years —and, unfortunately, not yet over— but, we hope, also in a broader context.

6. Case-law referred

Court of Justice of the European Union

Date	Case reference	Parties
17.7.2014	C-169/14	<i>Sánchez Morcillo et al. v. BBVA</i>
14.3.2013	C-415/11	<i>Aziz v. CatalunyaCaixa</i>
14.6.2012	C-618/10	<i>Banesto v. Joaquín Calderón Camino</i>
6.10.2009	C-40/08	<i>Asturcom v. Cristina Rodríguez Nogueira</i>
26.10.2006	C-168/05	<i>Mostaza Claro v. Centro Móvil Milenium SL</i>
27.6.2000	C-240/98 to C-244/98	<i>Océano Grupo Editorial et al. v. Rocío Murciano Quintero et al.</i>
22.4.1999	C-423/97	<i>Travel Vac v. José Antelm Sanchis</i>
7.3.1996	C-192/94	<i>El Corte Inglés v. Cristina Blázquez Rivero</i>

First Instance Courts

Location and date	Reference	Rapporteur
Avila, num. 3, 11.2.2014		
Miranda del Ebro, 15.2.2014		
Santander, num. 2, 19.11.2013	AC 2013\2287	<i>Jaime Francisco Anta González</i>
Marchena, num. 2, 16.8.2013	AC 2013\971	<i>Manuel Ruiz de Lara</i>

7. Bibliography

Ozlem AKIN, José GARCIA MONTALVO, Jaume GARCIA VILLAR, José Lu s PEYDR , and Josep Mar a RAYA (2014), "The real estate and credit bubble: evidence from Spain", *SERIEs-Journal of the Spanish Economic Association*, Issue 2-3, pp. 223-243.

M a  ngeles ALCAL  D AZ (2013), *La protecci n del deudor hipotecario*, Aranzadi, Madrid, p. 211.

 ngel CARRASCO PERERA (2013), "Consumidor que reclama judicialmente  nicamente la resoluci n del contrato de compraventa de un bien y posibilidad judicial de conceder una reducci n adecuada del precio", *Revista CESCO* (available at <http://blog.uclm.es/cesco/files/2013/10/Consumidor-que-reclama-judicialmente-%C3%BAnicamente-la-resoluci%C3%B3n-del-contrato-de-compraventa-de-un-bien.pdf>).

 ngel CARRASCO PERERA and Karolina LYCZKOWSKA (2014), "Un nuevo (y esta vez defectuoso) pronunciamiento del TJUE sobre el procedimiento hipotecario espa ol", *Revista CESCO* 10/2014 (2014) (available at <http://www.uclm.es/centro/cesco/pdf/trabajos/33/27.pdf>).

Clifford J. CARRUBBA and Lacey MURRAH (2005), "Legal integration and the use of the preliminary ruling process in the European Union", *International Organization*, Issue 59, pp. 399-418.

Marco CELENTANI and Fernando GÓMEZ POMAR (2012), "La dación en pago en el Código de Buenas Prácticas: ¿cuántos se benefician?", *Nada es Gratis* (available at <http://nadaesgratis.es/?p=22324>).

Marco CELENTANI, Miguel GARCÍA-POSADA and Fernando GÓMEZ POMAR (2010), "The Spanish Business Bankruptcy and the Crisis", *Working Paper 2010-11*, FEDEA.

Faustino Javier CORDÓN MORENO (2013), "La posibilidad de que el juez otorgue de oficio una tutela jurisdiccional no pedida por el consumidor (STJUE de 3 de octubre de 2013)", *Revista CESCO* 8/2013 (available at <http://blog.uclm.es/cesco/files/2013/11/La-posibilidad-de-que-el-juez-otorgue-de-oficio-una-tutela-jurisdiccional-no-pedida-por-el-consumidor.pdf>).

Federico DELLA NEGRA (2014), "Use of General or Specialist Rules in Private Law Relationships in the Financial Sector", *Mimeo*, European University Institute.

José María FERNÁNDEZ SEIJO (2013), *La defensa de los consumidores en las ejecuciones hipotecarias*, Bosch, Barcelona, p. 238.

Miguel GARCÍA-POSADA and Juan MORA-SANGUINETTI (2012), "Why do Spanish firms rarely use the bankruptcy system? The role of the mortgage institution". *Working Paper 1234*, Banco de España.

---(2014), "Are there alternatives to bankruptcy? A study of small business distress in Spain". *SERIEs- Journal of the Spanish Economic Association*.

Javier GÓMEZ GÁLLIGO (2014), "La doctrina del Tribunal de Justicia de la Unión Europea sobre calificación de las cláusulas abusivas en los préstamos hipotecarios", *Revista Crítica de Derecho Inmobiliario*, num. 741, pp. 153-175.

Fernando GÓMEZ POMAR (2001), "Directiva 1999/44/CE sobre determinados aspectos de la venta y las garantías de los bienes de consumo: una perspectiva económica", *InDret* 4/2001, p. 20 and ff.

Fernando GÓMEZ POMAR and Marco CELENTANI (2012), "Tarea urgente: el concurso personal", *InDret* 1/2012.

Lars HORNUF and Stefan VOIGT (2014), "Analyzing preliminary references as the powerbase of the European Court of Justice", *European Journal of Law and Economics*, July 2014.

INSTITUTO NACIONAL DE ESTADÍSTICA (2014), *Estadística sobre Ejecuciones Hipotecarias (EH). Segundo trimestre de 2014. Datos provisionales*, available at: <http://www.ine.es/daco/daco42/eh/eh0214.pdf>.

Karolina LYCZKOWSKA (2013), "Los intereses en los contratos de préstamo y las normas que rigen su licitud", *Revista CESCO* 5/2013 (available in <http://cesco.revista.uclm.es/index.php/cesco/issue/view/52/showToc>).

Juan Antonio MAYORAL DÍAZ-ASENCIO (2012), "Government Contained? Explaining Spanish Supreme Court's decisions on EU law", *Working Paper*, European University Institute.

---(2012a), "Overcoming the Legal Iron Curtain: Similarities and differences in the use of preliminary references between new and old Member States", *Perspectives on Federalism*, Issue 3, pp. 78-97.

Juan Antonio MAYORAL DÍAZ-ASENCIO, Dimitry BERBEROFF y David ORDÓÑEZ SOLÍS (2013), "El juez español como juez de la Unión Europea", *Revista Española de Derecho Europeo*, num. 48/2013, pp. 136.

Juan MORA-SANGUINETTI (2011), "The Regulation of Residential Tenancy Markets in Post-War Western Europe: An Economic Analysis". *European Journal of Comparative Economics*, Issue 1, pp. 47-75.

Atif MIAN and Amir SAFIR (2014), *House of Debt: How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again*, University of Chicago Press, Chicago.

Francisco RAMOS ROMEU (2006), "Law and Politics in the Application of EC Law: Spanish Courts and the ECJ 1986-2000", *Common Market Law Review*, num. 2, pp. 395-421.

M^a Isabel SAEZ LACAVE (2013), "Los derivados en el concurso. La racionalidad del régimen especial y las peculiaridades españolas", *InDret* 4/2013.

Alec STONE SWEET and Thomas BRUNELL (1998), "The European court and the national courts: A statistical analysis of preliminary references 1961-1995", *Journal of European Public Policy*, num. 14/1997, pp. 66-97.

Takis TRIDIMAS (2003), "Knocking on Heaven's Door: Fragmentation, Efficiency and Defiance in the Preliminary Reference Procedure", *Common Market Law Review*, Issue 1, pp. 9-50.

George TRIDIMAS and Takis TRIDIMAS (2004), "National courts and the European Court of Justice: A public choice analysis of the preliminary reference procedure", Issue 2, *International Review of Law and Economics*, pp. 125-145.

Maarten VINK, Monica CLAES and Christine ARNOLD (2009), "Explaining the use of preliminary references by domestic courts in EU member states: a mixed-method comparative analysis", *European Union Studies Association*.